Notes to financial statements

31 December 2004

1. Corporate Information

The Company was incorporated in Bermuda as an exempted company with limited liability under the Bermuda Companies Act 1981 (as amended) on 17 May 1999. The shares of the Company are listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”).

During the year, the Group offered an extensive range of whole life, endowment, unit-linked and term life insurance products to individuals in Hong Kong as well as other related products which included accident, medical and disability insurance to individuals, group life and accident, medical and disability insurance, and general insurance products through agency arrangements. The Group was also engaged in the administration of retirement schemes and asset management during the year.

In June 2002, Pacific Century Insurance Company Limited (“PCI”) (an indirect wholly owned subsidiary) entered into an agreement for the transfer of its Mandatory Provident Fund business (the “MPF business”) to HSBC Life (International) Limited (“HSBC Life”) . The related activities have been accounted for as discontinuing operations in the current financial statements, details of which are set out in note 36 to the financial statements.

The Group operates in one reportable business segment, being the provision of financial services, and in one reportable geographical segment, being Hong Kong.

In the opinion of the directors, the ultimate holding company is OS Holdings Limited, a company incorporated in Bermuda, as at the balance sheet date.

2. Impact of Recently Issued Hong Kong Financial Reporting Standards (“HKFRS”)

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

3. Summary of Significant Accounting Policies

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong for long term insurance companies and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the revaluation of investments and derivative financial instruments, as further explained below. They differ in certain material respects from the Company’s statutory financial statements prepared and filed with the Hong Kong Office of the Commissioner of Insurance.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

3. Summary of Significant Accounting Policies *(continued)*

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Goodwill

Goodwill arising on the acquisition of subsidiaries and associates represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and is amortised on the straight-line basis over its estimated useful life. In the case of associates, any unamortised goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet.

Prior to the adoption of SSAP 30 "Business combinations" in 2001, goodwill arising on acquisitions was eliminated against consolidated reserves in the year of acquisition. On the adoption of SSAP 30, the Group applied the transitional provision of the SSAP that permitted such goodwill to remain eliminated against consolidated reserves. Goodwill on acquisitions subsequent to the adoption of the SSAP is treated according to the SSAP 30 goodwill accounting policy above.

On disposal of subsidiaries or associates, the gain or loss on disposal is calculated by reference to the net assets on the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate. Any attributable goodwill previously eliminated against consolidated reserves at the time of acquisition is written back and included in the calculation of the gain or loss on disposal.

The carrying amount of goodwill, including goodwill remaining eliminated against consolidated reserves, is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

Profit recognition

The operating profits of the long term insurance business of the Group are arrived at annually by means of an actuarial valuation of future insurance liabilities, determined by the appointed actuary of the Group using a Net Level Premium approach. Detailed policies are as follows:

(i) acquisition costs relating to the production of new business are deferred to the extent that they can be recovered, and are shown explicitly as an asset in the balance sheet. Assumptions used in assessing the deferred acquisition costs reflect management's assessment of the most likely outcome of the future policy cash flows, subject to reasonable allowances for prudence purposes. All other acquisition costs and all maintenance costs are expensed as and when incurred;

(ii) amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities in the balance sheet; and

(iii) premiums relating to reinsurance contracts that do not transfer significant underwriting risk are treated as adjustments to the amounts carried in the balance sheet in respect of the contracts concerned.

3. Summary of Significant Accounting Policies *(continued)*

Premiums

Premiums in respect of traditional policies are recognised as income as and when they fall due, whereas those in respect of universal life, investment-linked contracts and group policies are accounted for as they are received. Contributions received in respect of the group retirement scheme management business are accounted for as income as they are received.

Premiums on reinsurance contracts that transfer underwriting risk are expensed as incurred. Premiums on reinsurance contracts that do not transfer significant underwriting risk are treated as adjustments to the amounts carried on the balance sheet in respect of the contracts concerned.

Investment income

Investment income is accounted for on a receivable basis. Dividend income from investments is recognised on the date on which the related investments are quoted as ex-dividend. Interest income from investments is accrued up to the balance sheet date.

Commissions

Commission received on reinsurance policies that transfer underwriting risk are recognised as income at the same time as the reinsurance premiums are accounted for. Amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities in the balance sheet. Commission payable to agents for the first policy year is included as a component of deferrable acquisition costs.

Deferred acquisition costs ("DAC")

The acquisition costs primarily related to the production of new business, are deferred in so far as there are sufficient margins in the future premiums of new business to fund the amortisation of the DAC. DAC include first year commissions and other costs related to the acquisition of new business.

DAC are carried at cost and amortised on the straight-line basis over ten years, adjusted for any unfavourable actual experience and any permanent impairment in value determined by reference to margins in the future premiums.

Insurance claims

Insurance claims are provided for as reported, whether admitted or not.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the revenue and profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

3. Summary of Significant Accounting Policies *(continued)*

Impairment of assets *(continued)*

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/ amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the revenue and profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the revenue and profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis so as to write off the cost of each asset over its estimated useful life. The principal estimated useful lives used for this purpose are as follows:

Leasehold land	50 years or the lease term, whichever is shorter
Buildings	40 years
Computer equipment	3 years
Furniture, fixtures and equipment	5 years
Motor vehicles	5 years

The gain or loss on disposal or retirement of a fixed asset recognised in the revenue and profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Investments

Held-to-maturity securities are investments in dated debt securities which the Group has the expressed intention and ability to hold to maturity, and are stated at amortised cost less any impairment losses which reflect their credit risk. Amortised cost is defined as cost plus or minus the cumulative amortisation of the difference between the purchase price and the maturity amount. An impairment loss is charged to the revenue and profit and loss account in the period in which it arises, on an individual investment basis.

In situations where the circumstances and events which led to an impairment of a held-to-maturity security cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future, the reversal of the impairment is credited to the revenue and profit and loss account, on an individual investment basis, to the extent of the amount previously charged.

Other investments, including bonds purchased for trading purposes, equities, equity linked notes, unit trusts and mutual funds, are stated at market or fair value. Any realised and unrealised gains or losses arising from changes in the fair values of other investments are dealt with in the revenue and profit and loss account for the period in which they arise.

3. Summary of Significant Accounting Policies *(continued)*

Real estate

Real estate represents the Group's interests in land and buildings held in respect of the Group's long term insurance business for investment purposes. Real estate is stated at cost less any impairment losses. This treatment is commonly adopted by life insurance companies in Hong Kong for such assets held in respect of long term insurance business and is permitted under the Hong Kong SSAP 13 "Accounting for investment properties".

Prepayments

Prepayments made in connection with the recruitment of agents are capitalised and amortised to the revenue and profit and loss account over the term of the contract with the agent.

Premiums receivable

Premiums receivable represent premiums which are due for payment. The Group normally allows policyholders to make payment within a grace period of one month from the due date. The grace period may be extended by one further month by management purely on a discretionary basis. Insurance policies continue in force if default premiums are settled before the expiry of the grace period.

Future insurance liabilities

Future insurance liabilities represent net future policy liabilities as determined by the appointed actuary of the Group using a Net Level Premium approach.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets and rentals receivable under the operating leases are credited to the revenue and profit and loss account on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the revenue and profit and loss account on the straight-line basis over the lease terms.

Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the revenue and profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences as at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

3. Summary of Significant Accounting Policies *(continued)*

Income tax *(continued)*

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the carry forward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and taxable profits will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised. Conversely, any previously unrecognised deferred tax asset is recognised to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Retirement benefits schemes

The Group provides a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and other allowances and are charged to the revenue and profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

Prior to the MPF Scheme becoming effective, the Group operated a defined contribution retirement benefits scheme (the "ORSO Scheme") for those employees who were eligible to participate in this scheme. The ORSO Scheme operated in a similar way to the MPF Scheme, except that when an employee left the ORSO Scheme before his/her interest in the Group's employer contributions vesting fully, the ongoing contributions payable by the Group were reduced by the relevant amount of the forfeited employer's contributions. With effect from 1 December 2000, the Group has operated both schemes and those employees who were eligible to participate in the ORSO Scheme are also eligible to participate in the MPF Scheme.

Share option scheme

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations.

The financial impact of share options granted under the share option scheme is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the revenue and profit and loss account or balance sheet for their cost. Upon the exercise of the share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date or which lapse, are deleted from the register of outstanding options.

3. Summary of Significant Accounting Policies *(continued)*

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's bye-laws grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Foreign currency transactions

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies as at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the consolidated revenue and profit and loss account.

Derivative financial instruments

The Group uses derivative financial instruments such as foreign currency forward contracts and treasury lock agreements to hedge risks associated primarily with foreign currency, interest rate and market fluctuations. Derivative financial instruments are valued at fair value. Any gain or loss is recognised in the revenue and profit and loss account.

The fair value of foreign currency forward contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management. For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Interest-bearing loans

Interest-bearing loans are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowings.

After initial recognition, interest-bearing loans are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Gain or losses are recognised in net profit or loss when the liabilities are derecognised or impaired, as well as through the amortisation process.

4. Turnover and Revenue

Turnover represents gross insurance premiums written, contributions received in respect of retirement scheme management, commissions received and receivable in respect of general insurance business conducted under agency agreements, and service fees from asset management.

An analysis of turnover, investment income, net gains and other income is as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
Revenue from:		
Life insurance business		
Single premium	**153,909**	6,224
First year premium	**290,047**	286,057
Renewal premium	**1,468,390**	1,362,864
	1,912,346	1,655,145
Retirement scheme business	**22,798**	28,587
Long term insurance business	**1,935,144**	1,683,732
General insurance business under agency agreements	**8,801**	8,135
Asset management business	**10,406**	5,416
Turnover	**1,954,351**	1,697,283

4. Turnover and Revenue *(continued)*

	Group	
	2004 **HK$'000**	2003 HK$'000
Investment income:		
General and shareholders' funds		
Interest income from listed investments	**171,374**	160,545
Interest income from banks and asset management businesses	**4,978**	10,256
Interest received from policy loans and loans to officers, employees and agents	**19,849**	21,819
Dividend income from listed investments	**19,441**	7,668
Investment handling charges	**(4,149)**	(6,419)
Provision for bad and doubtful debts	**(22,174)**	(989)
Others	**1,518**	1,260
	190,837	194,140
Segregated funds (note (i))		
Interest income from listed investments	**151**	255
Interest income from banks and asset management businesses	**4**	4
Investment handling charges	**(3,235)**	(3,059)
Others	**1,549**	1,380
	(1,531)	(1,420)
Investment Income	**189,306**	192,720
Net gains:		
Realised gains/(losses)		
General and shareholders' funds		
Realised gains on other listed investments	**144,439**	154,640
Realised gains on other unlisted investments	**13,779**	493
Realised losses arising from dealing in foreign currencies (note (ii))	**—**	(65)
	158,218	155,068
Segregated funds (note (i))		
Realised losses on other listed investments	**(19)**	(12)
Realised gains/(losses) on other unlisted investments	**2,430**	(139)
	2,411	(151)
Net realised gains	**160,629**	154,917
Unrealised (losses)/gains		
General and shareholders' funds		
Unrealised (losses)/gains on other listed investments	**(28,494)**	38,610
Unrealised gains on other unlisted investments	**75,911**	60,900
	47,417	99,510
Segregated funds (note(i))		
Unrealised gains/(losses) on other listed investments	**10**	(147)
Unrealised gains on other unlisted investments	**13,495**	46,053
	13,505	45,906
Net unrealised gains	**60,922**	145,416
Net gains	**221,551**	300,333

4. Turnover and Revenue *(continued)*

	Group 2004 HK$'000	2003 HK$'000
Investment income and net gains		
General and shareholders' fund	**396,472**	448,718
Segregated funds (note (i))	**14,385**	44,335
	410,857	493,053
Other income:		
Provision for premiums receivable written back	**—**	3,114
Reinsurance commission income and refund	**17,688**	14,876
Others	**47,697**	3,949
Other income	**65,385**	21,939
Investment income and net gains, and other income	**476,242**	514,992
Total revenue and net gains	**2,430,593**	2,212,275

The Group's income all arises from its activities conducted in Hong Kong.

Notes:

(i) The investment income and net gains amounting to a net gain of HK$14,385,000 (2003: Net gain of HK$44,335,000) on segregated funds will be offset by a change in future insurance liabilities relevant to segregated fund policies, and has had no impact on the consolidated revenue and profit and loss accounts.

(ii) The Group's insurance liabilities are predominantly denominated in United States dollars. It is the Group's policy to keep adequate assets in United States dollars in order to match its insurance liabilities. Where fixed interest securities (including bonds) and equity linked notes are denominated in currencies other than United States dollars, foreign currency forward contracts are bought to hedge back into United States dollars.

5. Policyholders' Benefits

	Group 2004 HK$'000	2003 HK$'000
Death and disability claims	**196,480**	176,167
Surrenders	**237,713**	335,600
Maturities and periodic payments	**103,640**	54,149
Policyholders' dividends	**105,013**	101,950
	642,846	667,866

6. Finance Costs

	Group	
	2004 **HK$'000**	2003 HK$'000
Interest on interest-bearing loans	**1,805**	—

7. Profit from Operating Activities

Profit from operating activities is arrived at after charging/(crediting):

	Group	
	2004 **HK$'000**	2003 HK$'000
Auditors' remuneration	**1,065**	1,133
Depreciation	**14,985**	17,789
Amortisation of deferred acquisition costs (note (i), and note 21)	**305,102**	302,948
Minimum lease payments under operating lease rentals on land and buildings	**19,788**	34,074
Staff costs (including directors' remuneration, note 9)	**141,832**	155,554
Retirement benefit scheme contributions:		
Employees	**8,080**	8,291
Agents	**8,902**	8,375
	16,982	16,666
Less: Forfeited contributions:		
Employees	**(605)**	(586)
Agents	**(846)**	(1,791)
	(1,451)	(2,377)
Net retirement benefit scheme contributions	**15,531**	14,289
	157,363	169,843
(Gain)/loss on disposal of fixed assets	**(99)**	6,868

Notes:

(i) The amortisation of deferred acquisition costs for the year is included in "Change in deferred acquisition costs" on the face of the revenue and profit and loss account, as disclosed in note 21 to the financial statements.

8. Profit Before Tax by Activity

Pursuant to the requirements of the Listing Rules, the profit before tax is analysed by activity as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
Life insurance business	**219,686**	238,529
Retirement scheme business	**(1,913)**	(4,653)
General insurance business under agency agreements	**2,716**	(380)
Asset management business (note (i))	**(6,603)**	(7,640)
Profit before tax	**213,886**	225,856

Note:

(i) Income from operation: Asset management	**41,282**	25,614
Less: Intra-Group income	**(30,876)**	(20,198)
	10,406	5,416
Operating expenses before tax	**(17,009)**	(13,056)
	(6,603)	(7,640)

The Group's profit before tax arises mainly from its direct underwriting activities conducted in Hong Kong.

9. Directors' Remuneration

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance is as follows:

	2004 **HK$'000**	**2003** **HK$'000**
Executive and non-executive directors:		
Fees	**1,320**	1,720
Salaries, allowances, and benefits in kind	**11,383**	13,407
Performance related bonuses	**11,609**	13,815
Contributions to retirement benefit schemes	**1,138**	1,021
	25,450	29,963
Independent non-executive directors:		
Fees	**360**	360
	25,810	30,323

The independent non-executive directors were appointed for an initial term of three years with effect from 8 June 1999, which was renewed for a further two years with effect from 8 June 2002. They are entitled to an annual directors' fee of HK$120,000 each. The non-executive director was appointed for an initial term of three years with effect from 30 November 2000, which was renewed for a further two years with effect from 30 November 2003.

The number of directors whose remuneration fell within the following bands is as follows:

	Number of directors	
	2004	**2003**
Nil - HK$1,000,000	**10**	10
HK$6,000,001 - HK$6,500,000	**2**	—
HK$7,000,001 - HK$7,500,000	**—**	2
HK$11,000,001 - HK$11,500,000	**1**	—
HK$12,500,001 - HK$13,000,000	**—**	1
	13	13

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

During the year, no share options were granted the directors in respect of their services to the Group under the share option schemes of the Company.

10. Five Highest Paid Employees

The five highest paid employees during the year included three (2003: three) directors, details of whose remuneration are set out in note 9 above. Details of the remuneration of the remaining two (2003: two) non-directors, highest paid employees for the year were as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
Salaries, housing allowances, and benefits in kind	**2,925**	2,679
Performance related bonuses	**7,389**	3,700
Contributions to retirement benefit schemes	**270**	245
	10,584	6,624

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2004	2003
HK$2,500,001 - HK$3,000,000	**—**	1
HK$3,500,001 - HK$4,000,000	**—**	1
HK$4,000,001 - HK$4,500,000	**1**	—
HK$6,000,001 - HK$6,500,000	**1**	—
	2	2

During the year, 2,100,000 share options were granted to the two non-director, highest paid employees in respect of their services to the Group, further details of which are included in the disclosures in note 29 to the financial statements. No value in respect of the share options granted during the year has been charged to the profit and loss account, or is otherwise in the above non-director, highest paid employees' remuneration disclosures.

11. Tax

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%) on the estimated assessable profits arising from the asset management business conducted in Hong Kong during the year.

The assessable profits of a wholly-owned subsidiary, which is engaged in the long term insurance business and retirement scheme management, are computed in accordance with the special provisions of the Hong Kong Inland Revenue Ordinance. Tax for the long term insurance business is computed at 17.5% (2003: 17.5%) of 5% of net premium (gross premium received less reinsurance premium ceded) from the life insurance business in accordance with Section 23(1)(a) of the Inland Revenue Ordinance rather than on taxable profits.

	2004 **HK$'000**	2003 HK$'000
Group:		
Current - Hong Kong		
Charge for the year	**6,629**	2,208
Overprovision in the prior year	**—**	(545)
Current - Elsewhere	**—**	147
Deferred (note 20)	**10,950**	8,007
Total tax charge for the year	**17,579**	9,817

A reconciliation of the tax expense applicable to profit before tax using the statutory rates to the tax expense at the effective tax rates are as follows:

	2004 **HK$'000**	**%**	2003 HK$'000	%
Profit before tax	**213,886**		225,856	
Tax at the statutory rate	**37,430**	**17.5**	39,524	17.5
Effect on opening deferred tax of increase in rates	**—**	**—**	(1,777)	(0.8)
Adjustments in respect of current tax of previous periods	**—**	**—**	(545)	(0.2)
5% of net premium of life insurance business	**13,697**	**6.4**	11,108	4.9
Profit of life insurance business and other businesses not taxable at statutory rate	**(33,548)**	**(15.7)**	(39,543)	(17.5)
Tax losses not recognised	**—**	**—**	1,050	0.4
Tax charge at the Group's effective rate	**17,579**	**8.2**	9,817	4.3

12. Net Profit From Ordinary Activities Attributable to Shareholders

The net profit from ordinary activities attributable to shareholders for the year dealt with in the financial statements of the Group and the Company are as follows:

	2004 HK$'000	2003 HK$'000
Group	**196,307**	216,039

	2004 HK$'000	2003 HK$'000
Company	**49,021**	95,623

13. Dividends

	2004 HK$'000	2003 HK$'000
Proposed:		
Final ordinary - HK$0.06 (2003: HK$0.06) per ordinary share	**49,256**	49,281
Special final - HK$0.04 (2003: Nil) per ordinary share	**32,838**	—
	82,094	49,281

The proposed final dividend of HK$49,256,000 and the proposed special final dividend of HK$32,838,000 for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

14. Earnings Per Share

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of HK$196,307,000 (2003: HK$216,039,000) and the weighted average of 820,737,000 (2003: 821,571,000) ordinary shares in issue during the year.

The calculation of diluted earnings per share is based on the net profit attributable to shareholders for the year of the HK$196,307,000 (2003: HK$216,039,000). The weighted average number of ordinary shares used in the calculation is 820,737,000 (2003: 821,571,000) ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average of 14,599,000 (2003: 1,623,000) ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options during the year.

15. Fixed Assets

Group	Leasehold land and buildings HK$'000	Computer equipment HK$'000	Furniture, fixtures and equipment HK$'000	Motor vehicles HK$'000	Software under development HK$'000	Total HK$'000
Cost:						
As at 1 January 2004	226,971	28,531	74,614	2,656	401	333,173
Additions	—	1,084	8,859	—	—	9,943
Disposals	—	(305)	(1,283)	(393)	(43)	(2,024)
Transfers	—	358	—	—	(358)	—
As at 31 December 2004	226,971	29,668	82,190	2,263	—	341,092
Accumulated depreciation:						
As at 1 January 2004	29,007	22,314	58,646	2,213	—	112,180
Provided during the year	5,050	3,245	6,600	90	—	14,985
Disposals	—	(305)	(1,260)	(393)	—	(1,958)
As at 31 December 2004	34,057	25,254	63,986	1,910	—	125,207
Net book value:						
As at 31 December 2004	192,914	4,414	18,204	353	—	215,885
As at 31 December 2003	197,964	6,217	15,968	443	401	220,993

Details of the Group's leasehold land and buildings included above, which are held under medium term leases and stated at cost, are as follows:

	Group	
	2004 HK$'000	2003 HK$'000
Hong Kong	**216,520**	216,520
Elsewhere	**10,451**	10,451
	226,971	226,971

16. Interests in Subsidiaries

	Company 2004 HK$'000	2003 HK$'000
Unlisted shares, at cost	**365,924**	365,924
Amounts due from subsidiaries	**537,123**	478,754
	903,047	844,678
Provision for impairment	**—**	—
	903,047	844,678

The amounts due from subsidiaries are unsecured, interest-free and are not repayable within the next 12 months.

Particulars of the principal subsidiaries are as follows:

Name	Place of incorporation and operations	Nominal value of issued share capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
Bright Victory International Limited	British Virgin Islands/ Hong Kong	Ordinary US$7,743,935	100	—	Investment holding
Pacific Century Insurance Company Limited	Bermuda/Hong Kong	Ordinary US$121,000,000 Redeemable US$9,000,000	—	100	Life assurance, administration of retirement schemes and other related businesses
Pacific Century Trustees Limited	Hong Kong	Ordinary HK$30,000,000	—	100	Provision of trustee services
PCI Investment Management Limited	Hong Kong	Ordinary HK$10,000,000	100	—	Asset management
PCI Capital Limited	British Virgin Islands	Ordinary US$1	—	100	Note issuance

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

17. Investments

	Group 2004 HK$'000	2003 HK$'000
Bonds held-to-maturity, at amortised cost listed elsewhere other than Hong Kong	**137,105**	136,876
Market value of listed held-to-maturity bonds	**136,098**	135,870

The held-to-maturity bonds analysed by category of issuer as at the balance sheet date were as follows:

	Group 2004 HK$'000	2003 HK$'000
Corporate entities	**137,105**	136,876

The maturity profile of the held-to-maturity bonds as at the balance sheet date is as follows:

	Group 2004 HK$'000	2003 HK$'000
With a residual maturity of:		
Five years or less but over one year	**137,105**	136,876

18. Loans

	Group 2004 HK$'000	2003 HK$'000
Policy loans	**216,173**	194,868
Loans to officers, employees and agents	**40,944**	78,191
	257,117	273,059

The policy loans are made to policyholders and secured by the policies' cash surrender value. Policy loans are repayable at the discretion of the policyholders as long as the interest plus the principal of the loans do not equal or exceed the cash value or until the policy matures.

The Group provides loans to directors, employees and agents which are interest-bearing at the prevailing bank lending rates, some of which are secured by the underlying properties and/or motor vehicles, and are repayable by monthly instalments.

No loans had been provided to directors as at the current or prior year balance sheet dates.

19. Real Estate

The Group's real estate is situated in Mainland China and is held under the following lease terms:

	2004 HK$'000	2003 HK$'000
Long term leases	**3,589**	3,589
Medium term leases	**11,730**	11,730
	15,319	15,319

20. Deferred Tax

The movement in the deferred tax asset during the year was as follows:

Deferred tax asset

Group	2004 Losses available for offset against future taxable profits HK$'000
As at 1 January 2004	**10,950**
Deferred tax charged to the revenue and profit and loss account during the year	**(10,950)**
Gross and net deferred tax asset as at 31 December 2004	**—**

	2003 Losses available for offset against future taxable profits HK$'000
As at 1 January 2003	18,957
Deferred tax charged to the revenue and profit and loss account during the year	(8,007)
Gross and net deferred tax asset as at 31 December 2003	10,950

As at 31 December 2004, there were no significant unrecognised deferred tax liabilities (2003: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries as the Group had no liability to additional tax should such an amount be remitted.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

21. Deferred Acquisition Costs

	Group	
	2004	2003
	HK$'000	HK$'000
Balance as at beginning of the year	**1,403,273**	1,507,518
Additions	**211,225**	198,703
Less: Amortisation	**(305,102)**	(302,948)
Change in deferred acquisition costs	**(93,877)**	(104,245)
Balance as at 31 December	**1,309,396**	1,403,273
Current portion	**(286,168)**	(301,257)
Non-current portion	**1,023,228**	1,102,016

22. Short Term Investments

	Group	
	2004	2003
	HK$'000	HK$'000
Listed bonds, at market value:		
Hong Kong	**769,310**	917,683
Elsewhere	**2,303,271**	2,551,492
	3,072,581	3,469,175
Listed equity investments, at market value:		
Hong Kong	**145,390**	148,628
Elsewhere	**1,225,433**	190,106
	1,370,823	338,734
Unlisted unit trusts, at fair value	**681,947**	628,322
Unlisted mutual fund, at fair value	**657,142**	251,525
	5,782,493	4,687,756

22. Short Term Investments *(continued)*

Listed bonds analysed by category of issuer as at the balance sheet date were as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
Governments	**431,430**	624,798
Banks and other financial institutions	**1,209,908**	1,220,333
Corporate entities	**1,431,243**	1,624,044
Listed bonds	**3,072,581**	3,469,175

The maturity profile of the listed bonds as at the balance sheet date were as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
With a residual maturity of:		
Three months or less	**—**	2,025
One year or less but over three months	**300,278**	8,725
Five years or less but over one year	**1,079,603**	1,585,349
Over five years	**1,692,700**	1,873,076
Listed bonds	**3,072,581**	3,469,175

As at 31 December 2004, the Group held bonds with a nominal amount of US$10,000,000 (2003: US$10,000,000) issued by PCCW Capital Limited, which have a maturity date in 2005. The market value of these bonds amounted to HK$93,085,000 (2003: HK$92,929,000) as at the balance sheet date.

During 2004, the Group had not sold any PCCW Capital Limited bonds (2003: US$4,000,000 (equivalent to HK$31,199,000)).

23. Cash and Cash Equivalents

	Group		Company	
	2004 **HK$'000**	2003 HK$'000	**2004** **HK$'000**	2003 HK$'000
Cash and bank balances	**1,072,041**	310,111	**18**	138
Time deposits	**229,504**	178,869	**—**	12,567
	1,301,545	488,980	**18**	12,705

The maturity profile of the time deposits as at the balance sheet date were as follows:

	Group		Company	
	2004 **HK$'000**	2003 HK$'000	**2004** **HK$'000**	2003 HK$'000
With a residual maturity of:				
Three months or less	**227,425**	176,800	**—**	12,567
One year or less but over three months	**2,079**	2,069	**—**	—
	229,504	178,869	**—**	12,567

24. Premium Deposits

Premium deposits are amounts that are left in deposit with the Group for the payment of future premiums.

25. Due to Related Companies

The amounts due to related companies arose from the ordinary and normal course of business with terms similar to those offered to other customers of the Group.

26. Interest-Bearing Loans

On 17 December 2004, a wholly-owned subsidiary of the Company, PCI Capital Limited ("PCI Capital"), issued an aggregate principal amount of US$100 million (approximately HK$780 million) with a coupon rate of 5.875% guarantee bonds (the "Bonds") due 17 December 2014 to independent third party investors. PCI Capital raised approximately HK$767,186,000 (US$98,648,000), net of expenses. PCI Capital loaned the net proceeds to its immediate holding company, Pacific Century Insurance Company Limited ("PCI"), to be used by PCI to enter the life insurance market in Mainland China and for working capital purposes.

Interest on the bonds is payable on 17 June and 17 December of each year, beginning on 17 June 2005. The Bonds are fully and unconditionally guaranteed by PCI. PCI's guarantee is its unsecured and unsubordinated obligation which ranks equally with all of PCI's other exiting and future unsecured and unsubordinated obligations. As required by the insurance laws of Hong Kong and Bermuda, PCI's guarantee is effectively junior to the liabilities of its long term business, to the extent of the assets maintained by PCI in respect of its long term business. The Bonds are listed on the Main Board of the Singapore Exchange Securities Trading Limited and under the provision of Rule 144A of the United States Securities Act.

26. Interest-Bearing Loans *(continued)*

The Bonds will be fully matured on 17 December 2014. Accordingly, the Bonds have been classified as non-current liabilities as at the balance sheet date.

27. Future Insurance Liabilities

	Group	
	2004 **HK$'000**	2003 HK$'000
Life insurance business		
As at 1 January	**3,959,568**	3,492,814
Increase for the year	**732,608**	478,225
Currency realignment	**3,922**	(11,471)
As at 31 December	**4,696,098**	3,959,568
Retirement scheme business		
As at 1 January	**192,055**	244,694
Decrease for the year	**(537)**	(52,639)
As at 31 December	**191,518**	192,055
As at 31 December	**4,887,616**	4,151,623

28. Share Capital

	Company			
	2004		2003	
	Number of shares	**Nominal value HK$'000**	Number of shares	Nominal value HK$'000
Authorised:				
Ordinary shares of HK$1.00 each	**3,000,000,000**	**3,000,000**	3,000,000,000	3,000,000
Issued and fully paid:				
Ordinary shares of HK$1.00 each	**820,938,000**	**820,938**	821,350,000	821,350

During the year, the movements in share capital were as follows:

(a) A total of 3,292,000 ordinary shares of HK$1.00 each were repurchased by the Company during the year at prices ranging from HK$2.65 to HK$3.00 per share. The aggregate price paid by the Company for such repurchases, before share repurchase expenses, was HK$9,042,000.

The repurchased shares were cancelled and the issued share capital of the Company was reduced by the par value thereof. The premium paid on the repurchase of the shares and related expenses, in the amount of HK$5,791,000, was charged to the share premium account, as disclosed in the consolidated statement of changes in equity and in note 30(b) to the financial statements.

28. Share Capital *(continued)*

(b) The subscription rights attaching to 2,880,000 share options were exercised at the subscription price of HK$2.05 per share (note 29), resulting in the issue of 2,880,000 shares of HK$1.00 each for a total cash consideration, before expenses, of HK$5,904,000.

A summary of the transactions during the year with reference to the above movements in the Company's issued share capital is as follows:

	Number of shares in issue	Issued share capital HK$'000	Share premium account HK$'000	Total HK$'000
As at 1 January 2004	821,350,000	821,350	26,219	847,569
Shares repurchased and cancelled (a)	(3,292,000)	(3,292)	(5,750)	(9,042)
	818,058,000	818,058	20,469	838,527
Share options exercised (b)	2,880,000	2,880	3,024	5,904
	820,938,000	820,938	23,493	844,431
Shares repurchase expenses (a)	—	—	(41)	(41)
As at 31 December 2004	820,938,000	820,938	23,452	844,390

Share options

Details of the Company's share option scheme and the share options issued under the scheme, are included in note 29 to the financial statements.

29. Share Option Schemes

The Company operates share option schemes for the purpose of attracting, retaining and motivating talented participants to strive for future development and the expansion of the Group. The schemes are designed to act as an incentive to encourage the participants and allow them to enjoy the results of the Company attained through their efforts and contributions.

Eligible participants of the share option scheme adopted on 16 June 1999 (the "Old Share Option Scheme") included (a) any employee as well as any executive director of the Group; and (b) any agent who had agreed by a contract in writing to render full-time and exclusive services to the Group and (for new options only), who had or would have, rendered such services for a continuous period of at least 12 months as at the date of grant. As the Old Share Option Scheme was terminated with effect from 6 May 2002, no further options may be offered pursuant to this scheme, however for outstanding options in existence, the provisions of the Old Share Option Scheme remain in force.

Eligible participants of a share option scheme adopted on 6 May 2002 (the "New Scheme") include (a) any employee or executive director of the Group; (b) any advisor or consultant to the Group (including any executive or employee of this advisor or consultant); and (c) any agent who has agreed by a contract in writing to render full-time and exclusive services to the Group. The New Scheme was adopted on 6 May 2002, and unless otherwise cancelled or amended, will be valid and effective for a period of 10 years commencing from that date. During the year, a total of 3,720,000 share options were granted under the New Scheme.

As at 31 December 2004, the number of shares issuable under the New Scheme and the Old Share Option Scheme was 70,654,390, which represented approximately 8.61% of the Company's shares in issue as at that date. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 70,654,390 additional ordinary shares of the Company and additional share capital of HK$70,654,000 and share premium of HK$169,957,000 (before issue expenses).

29. Share Option Schemes *(continued)*

The total number of shares which may be issued upon exercise of all options to be granted under the New Scheme and any other share option schemes of the Company shall not exceed 10% of the total number of shares in issue as at the date of approval of the New Scheme unless the Company obtains a fresh approval from its shareholders. Notwithstanding the above, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the New Scheme and any other share option schemes shall not exceed 30% of the total number of shares in issue from time to time. The maximum number of shares issuable under share options to each eligible participant pursuant to the share option schemes within any 12-month period, is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

Each grant of options to a director, chief executive, substantial shareholder or any of their respective associates is subject to approval by the independent non-executive directors (excluding the independent non-executive director who is the grantee of the options), where any grant of options granted to a substantial shareholder or an independent non-executive director or any of their respective associates would result in the securities issued and to be issued upon exercise of all options already granted and to be granted to such person in the 12-month period up to and including the date of such grant, representing in aggregate over 0.1% of the shares of the Company in issue and having an aggregate value (based on the closing price of the Company's shares as at the date of each grant) in excess of HK$5 million, are subject to shareholders' approval in a general meeting. All connected persons of the Company must abstain from voting at such a general meeting.

The offer of a grant of share options may be accepted within 28 days from the date of the offer, upon payment of a nominal consideration of HK$1 by the grantee. The exercise period of the share options granted is determinable by the directors, and unless resolved otherwise, commences on the first anniversary of the date of grant and ends on a date which is not later than five years from the relevant exercise date of the share options or 10 years from the date of grant of share options, if earlier.

The exercise price of the share options is determinable by the directors, and must be at least the higher of (i) the Stock Exchange closing price of the Company's shares on the date of the offer of the share options; (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of the offer, and (iii) the nominal value of the Company's shares.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

As at 31 December 2004, the Company had 70,654,390 (2003: 73,222,990) outstanding share options. Details of the share options outstanding during the year ended 31 December 2004 were as follows:

(i) Directors

	Number of share options									Price of Company's shares	
Name of director	As at 1 January 2004	Granted during the year	Exercised during the year	Lapsed during the year	As at 31 December 2004	Date of grant of share options	Vesting period	Exercisable period of share options	Exercise price of share options HK$	As at grant date of options HK$	As at exercise date of options HK$
YUEN Tin Fan, Francis	19,440,000	–	–	–	19,440,000	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	5.233	–	–
CHAN Ping Kan, Raymond	8,000,000	–	–	–	8,000,000	20 June 2003	20 June 2004 to 20 March 2006	20 June 2004 to 19 March 2011	1.62	–	–
ALLEN Peter Anthony	600,000	–	–	–	600,000	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	5.233	–	–
CHEUNG Sum, Sam	4,000,000	–	–	–	4,000,000	29 August 2003	29 August 2004 to 29 August 2006	29 August 2004 to 28 August 2011	2.05	–	–
CHUNG Cho Yee, Mico	2,280,000	–	–	–	2,280,000	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	5.233	–	–
SO Wing Hung, Peter	4,000,000	–	–	–	4,000,000	29 August 2003	29 August 2004 to 29 August 2006	29 August 2004 to 28 August 2011	2.05	–	–
	38,320,000	–	–	–	38,320,000						

29. Share Option Schemes *(continued)*

(ii) Other employees

	Number of share options									Price of Company's shares	
	As at 1 January 2004	Granted during the year	Exercised during the year	Lapsed during the year	As at 31 December 2004	Date of grant of share options	Vesting period	Exercisable period of share options	Exercise price of share options HK$	As at grant date of options HK$	As at exercise date of options HK$
In aggregate	1,700,400	–	–	(591,600)	1,108,800	7 July 1999	7 July 2000 to 7 July 2002	7 July 2000 to 6 July 2007	4.187	–	–
	367,200	–	–	–	367,200	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	4.448	–	–
	9,420,000	–	(1,430,000)	(2,520,000)	5,470,000	29 August 2003	29 August 2004 to 29 August 2006	29 August 2004 to 28 August 2011	2.05	–	3.09
	–	2,640,000	–	–	2,640,000	2 March 2004	2 March 2005 to 2 March 2007	2 March 2005 to 1 March 2012	3.84	3.775	–
	–	1,080,000	–	–	1,080,000	4 October 2004	4 October 2005 to 4 October 2007	4 October 2005 to 3 October 2012	2.825	2.825	–
	11,487,600	3,720,000	(1,430,000)	(3,111,600)	10,666,000						

(iii) Others (Agents)

In aggregate	5,304,390	–	–	(71,400)	5,232,990	7 July 1999	7 July 2000 to 7 July 2002	7 July 2000 to 6 July 2007	4.187	–	–
	3,314,040	–	–	(75,600)	3,238,440	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	4.448	–	–
	126,960	–	–	–	126,960	7 July 1999	7 July 2000 to 7 July 2004	7 July 2000 to 6 July 2009	5.233	–	–
	14,670,000	–	(1,450,000)	(150,000)	13,070,000	29 August 2003	29 August 2004 to 29 August 2006	29 August 2004 to 28 August 2011	2.05	–	3.01
	23,415,390	–	(1,450,000)	(297,000)	21,668,390						
Total	73,222,990	3,720,000	(2,880,000)	(3,408,600)	70,654,390						

No share option was cancelled during the year ended 31 December 2004.

The price of the Company's shares disclosed as at the date of the grant of the share option is the Stock Exchange closing price on the trading day immediately prior to the date of the grant of the options. The price of the Company's shares disclosed as at the date of the exercise of the share options is the weighted average of the Stock Exchange closing prices over all of the exercises of options within the disclosure line.

The 2,880,000 share options exercised during the year resulted in the issue of 2,880,000 ordinary shares of the Company and new share capital of HK$2,880,000 and share premium of HK$3,024,000 (before issue expenses), as detailed in note 28 to the financial statements.

30. Reserves

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 48 of the financial statements.

The Group's contributed surplus represents the difference between the nominal value of the shares and the share premium account of the Group's then holding company acquired pursuant to the group reorganisation in 1999, over the nominal value of the Company's shares issued in exchange upon the reorganisation.

As detailed in note 3 to the financial statements, the Group eliminated goodwill against reserves in respect of acquisitions which occurred prior to 1 January 2001. The amount of goodwill remaining eliminated against consolidated retained profits, arising from the acquisition of a subsidiary prior to 1 January 2001, is HK$56,586,000 as at 1 January and 31 December 2004. The goodwill is stated at cost.

(b) Company

	Notes	Share premium account HK$'000	Contributed surplus (note (i)) HK$'000	Retained profits HK$'000	Total HK$'000
Balance as at 1 January 2003		26,731	7,392	159	34,282
Shares repurchased and cancelled	28	(512)	—	—	(512)
Net profit for the year		—	—	95,623	95,623
Proposed final 2003 dividend		—	—	(49,281)	(49,281)
As at 31 December 2003		26,219	7,392	46,501	80,112
Issue of shares		3,024	—	—	3,024
Shares repurchased and cancelled	28	(5,750)	—	—	(5,750)
Shares repurchase expenses	28	(41)	—	—	(41)
Net profit for the year		—	—	49,021	49,021
Proposed 2004 dividends					
Final ordinary		—	—	(49,256)	(49,256)
Special final		—	—	(32,838)	(32,838)
As at 31 December 2004		23,452	7,392	13,428	44,272

Notes:

(i) The contributed surplus of the Company represents the excess of the fair value of the shares of the subsidiaries acquired pursuant to the group reorganisation in 1999, over the nominal value of the Company's shares issued in exchange upon the reorganisation. Under the Bermuda Companies Act 1981 (as amended), the Company may make distributions to its members out of the contributed surplus under certain circumstances.

(ii) The Company depends primarily on dividends from its life insurance subsidiary in order to pay dividends to shareholders. Hong Kong insurance legislation limits the extent of retained earnings that can be paid to the Company, through the use of minimum solvency margins and prudent regulations over the value of actuarial liabilities.

As at 31 December 2004, the Company had distributable reserves amounting to HK$20,820,000 (2003: HK$53,893,000).

31. Contingent Liabilities

As at 31 December 2004, the Group and the Company had no material contingent liabilities other than as set out below in note 32 and contingencies arising from the ordinary course of the long term insurance business (2003: Nil).

32. Pending Litigation

On 21 September 2000, a writ was issued against a number of persons, including PCI and certain insurance agents of PCI, by certain members of an insurance group operating in Hong Kong (the "Plaintiffs"), whereby the Plaintiffs sought, among other things, injunctive relief and damages against PCI in connection with PCI's plan matching scheme and the purported use of certain documents and information.

On 24 July 2001, a High Court judge granted the Plaintiffs interim injunctive relief pending the trial of the action or further order. The interim injunctive relief restrains PCI, among others, from disclosing or otherwise making any use of certain documents and information, and accepting applications for life insurance policies in certain circumstances.

Having consulted legal counsel, the Group has determined that it will continue to vigorously defend these proceedings. In the opinion of the directors and based on legal advice, it is unlikely that the final outcome of these proceedings would materially affect the financial position of the Group.

33. Operating Lease Arrangements

(a) As lessor

The Group leases its real estate (note 19 to the financial statements) under operating lease arrangements, with leases negotiated for terms ranging from two to three years. The terms of the leases generally also require the tenants to pay security deposits and provide for periodic rent adjustments according to the then prevailing market conditions.

As at 31 December 2004, the Group had total future minimum lease receivables under non-cancellable operating leases with its tenants falling due as follows:

	Group	
	2004 **HK$'000**	**2003** **HK$'000**
Within one year	**1,313**	1,231
In the second to fifth years, inclusive	**846**	1,016
	2,159	2,247

33. Operating Lease Arrangements *(continued)*

(b) As lessee

The Group leases certain of its office properties under operating lease arrangements. Leases for properties are negotiated for terms ranging from two to three years.

As at 31 December 2004, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group	
	2004 **HK$'000**	2003 HK$'000
Within one year	**20,699**	19,397
In the second to fifth years, inclusive	**16,797**	32,081
	37,496	51,478

34. Commitments

(a) In addition to the operating lease commitments detailed in note 33(b) above, the Group and the Company had the following commitments as at the balance sheet date:

	Group and Company	
	2004 **HK$'000**	2003 HK$'000
Contracted, but not provided for:		
Purchases of furniture and fixtures	**1,356**	—
Service charge under a healthcare agreement	**—**	2,941

(b) Derivative financial instruments

The Group uses derivative financial instruments such as foreign currency forward contracts and treasury lock agreements to hedge risks associated primarily with foreign currency, interest rate and market fluctuations. There were no outstanding derivative financial instruments commitments as at 31 December 2004 (2003: Nil).

35. Related Party Transactions

(a) Details of the material transactions with companies related to the Group were as follows:

	Notes	Group 2004 HK$'000	2003 HK$'000
Premium income in respect of group life and medical policies issued to:	(i)		
Pacific Century Asset Management (HK) Limited (trading as "Pacific Century Group")		**1,833**	2,465
PCCW Services Limited		**1,972**	1,603
		3,805	4,068
General insurance commission income received from The Ming An Insurance Company (Hong Kong), Limited	(ii)	**7,409**	6,961

Notes:

(i) The Group entered into a number of group life and medical policies with certain companies which are associates of Mr. Richard Li and Pacific Century Regional Developments Limited. In the opinion of the directors (including the independent non-executive directors), the group life and medical policies for these related companies are negotiated and conducted on terms and conditions similar to those offered to other customers of the Group, in the ordinary and usual course of business of the Group and on terms that are fair and reasonable so far as the shareholders of the Company are concerned. The total amount of premium income derived therefrom did not exceed 2% of the total turnover of the Group for the year ended 31 December 2004.

(ii) Pursuant to an agency agreement dated 1 November 1994 and subsequently replaced by an Agency Agreement effective from 1 January 2001, Pacific Century Insurance Company Limited, a wholly-owned subsidiary of the Group, was, with effect from 1 January 2001 appointed as an underwriting agent of The Ming An Insurance Company (Hong Kong), Limited ("Ming An"), with authorisation to underwrite and to settle claims of certain types of general insurance businesses on behalf of Ming An.

On 8 November 2004, PCI and Ming An entered into a supplemental agreement to amend the duration of the Agency Agreement for not more that three years for the sole purpose of complying with Rule 14A.35 of the Listing Rules (the "Supplemental Agreement"). Pursuant to the Supplemental Agreement, the terms of the Agency Agreement have been amended to not more than three years which will expire on 31 March 2007 and will be automatically renewed for another three years until being terminated pursuant to the terms of the Agency Agreement with effect from 8 November 2004.

(b) The Group provides loans to employees and agents which are interest-bearing at the prevailing bank lending rates, some of which are secured by the underlying properties and/or motor vehicles, and are repayable on a monthly instalment basis.

The related party transactions in respect of item (a) above also constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

36. Discontinuing Operations

In June 2002, PCI entered into an agreement for the transfer of its MPF business to HSBC Life. The disposal is consistent with the Company's long term strategy to focus on providing an extensive range of whole life, endowment, unit-linked and term life insurance products to individuals in Hong Kong as well as being engaged in asset management. The transfer of the MPF business commenced in July 2002, and the Group plans to complete the transfer by the end of 2005.

The revenue, operating expenses and net loss of the MPF business for the years ended 31 December were as follows:

	2004 HK$'000	2003 HK$'000
REVENUE		
Turnover	**1,343**	9,399
Investment gain	**3,829**	11,771
Total revenue	**5,172**	21,170
OPERATING EXPENSES		
Policyholders' benefits	**(12,950)**	(90,020)
Agency commission and allowances	**(2)**	(69)
Management expenses	**(872)**	(1,738)
Total operating expenses	**(13,824)**	(91,827)
Decrease in future insurance liabilities	**8,086**	69,738
LOSS BEFORE TAX	**(566)**	(919)
Tax	**—**	—
NET LOSS FOR THE YEAR	**(566)**	(919)

The carrying amounts of the total assets and liabilities of the MPF business as at 31 December 2004 and 31 December 2003 were as follows:

	2004 HK$'000	2003 HK$'000
Total assets	**64,996**	73,052
Total liabilities	**(31,651)**	(39,141)
Net assets	**33,345**	33,911

36. Discontinuing Operations *(continued)*

The net cash flows attributable to the MPF business were as follows:

	2004 HK$'000	2003 HK$'000
Operating	**(76)**	(1,591)
Investing	**—**	—
Financing	**—**	—
Net cash outflows	**(76)**	(1,591)

37. Approval of the Financial Statements

The financial statements were approved and authorised for issue by the board of directors on 23 February 2005.